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DEPT FOR WHA/EPSC FAITH CORNEILLE
USTR FOR BENNETT HARMAN

E.O. 12958: DECL: 01/16/2019
TAGS: EINV ENRG ECON EC
SUBJECT: U.S. MACHALA POWER REACHES AGREEMENT WITH GOE ON INVESTMENT DISPUTE

REFTEL A: QUITO 1
B: 08 QUITO 966
C: 08 QUITO 681
D: 08 QUITO 314

Classified By: DCM Andrew Chritton, Reasons 1.4 (b&d)

¶1. (C) Summary. U.S. electricity generator Machala Power signed an agreement with the GOE December 19 to drop its arbitration claim in exchange for payment of approximately $70 million to cover past due GOE debts (payment and termination of the arbitration claim are still pending). The company had hoped to resolve all of its outstanding issues before dropping arbitration, but chose to settle before Ecuador's financial situation deteriorated further. GOE approval to waive additional Machala investment commitments in electricity, and for sister company EDC to develop natural gas are still outstanding. End Summary.

¶2. (U) On December 19, Machala Power, one of the two remaining U.S. electricity companies in Ecuador, signed an agreement with the GOE regarding debt owed by the government. The debt accrued when government-owned electricity distributors failed to fully pay Machala Power for electricity that it supplied. Machala Power is to be paid $59.8 million in cash in January 2009, and the remaining balance (approximately $10 million) 10 days later. In exchange, Machala Power will withdraw its international arbitration claim. A December 24 statement on the Presidency website announced the agreement. To date, Machala Power has not received payment.

Machala Power and EDC

¶3. (SBU) One of Noble Energy's two subsidiaries in Ecuador, Machala Power generates electricity using natural gas produced by its sister company EDC. Machala Power filed for international arbitration in March 2005, but continued to seek a negotiated settlement with the GOE. The company has been working to resolve its dispute with the GOE for several years (in October 2008, Machala signed a statement of intent with the GOE, agreed on the debt amount, and was very close to resolving some of its issues, reftel B. However, the two sides did not reach final agreement).

¶4. (SBU) Previously, Machala Power had been unwilling to withdraw its arbitration case without resolving its other problems. Noble Energy would like to get out of electricity generation in Ecuador and focus on natural gas production through EDC. In light of this, the company wants to obtain approval to waive additional investment requirements in Machala Power's investment plan, which is currently in force majeure. Other pending issues include guarantees of future payment for electricity generation; obtaining approval for EDC's

development plan for natural gas, and agreeing on a price to sell gas from EDC to the state.

Settle Now While Funds Available

¶5. (C) Machala Power General Manager John Tomich explained that Ecuador's poor economic outlook led the company to agree to settle past debts and drop its arbitration, even though other issues still remain. He said that the company was "getting scared" that the GOE would run out of money, and that if they waited and tried to resolve all of Machala Power/EDC's issues at once, funds might not be available for payment in 2009. In fact, Tomich expressed concern that the possibility of the GOE buying Machala Power, discussed extensively in November 2008, may no longer be viable.

Comment:

¶6. (C) This is another case of the GOE resolving an investment dispute with a U.S. company, following agreements with Occidental Petroleum (on one of its cases), City Oriente, and Duke Energy in 2008 (reftels D,C, and A). The payment amount is significant - $70 million, much larger than Duke Energy's payment of $10 million. Machala Power wants out of the problematic electricity sector (hopefully by selling to the GOE), but sister company EDC plans to remain in Ecuador and expand its natural gas production, selling to state oil company Petroecuador. Both companies still face a number of issues before these plans can be realized, which could become more difficult to resolve as the GOE's financial situation worsens.

HODGES